

**50. How should a bidding system be structured in order to provide incentives for carriers to compete to submit the low bid for universal service support?**

Prior to the 1996 Act, TW Comm proposed that the most effective incentive would be to award support only to the low bidder. However, this proposal appears to conflict with the 1996 Act's provisions on eligibility. As an alternative, TW Comm proposes that only the lowest bidder be entitled to receive 100% of its winning (low) bid, while all other bidders would receive only a percentage of the support level determined through the bidding process. This approach could be enhanced by combining a percentage-based penalty for LECs with non-winning bids with a variable penalty, based on the difference between the low bid and the other LEC's higher bid. Take, for example, a contest in which the low bid, by Carrier A, is \$10, and the two other participants, Carriers B and C, bid \$12 and \$15, respectively. As a starting point, Carriers B and C should receive no more than 80% of the winning (low) support amount. Then, in addition, there should be an incremental discount to that support, based on how much the bids by Carriers B and C exceeded the low bid (i.e., some portion of the \$3 and \$5 differential between their bids and Carrier A's \$10 bid). Taken in combination, these penalties would put pressure on carriers to bid as low as possible.

To ensure a fair and truly competitive bidding process, it is also critical that all participants have equivalent access to relevant information. Thus, the ILEC should be required to make full disclosure of the market characteristics (including both costs and revenues). In addition, in order to ensure that

support levels are updated to reflect current costs and current competitive conditions, the support levels should be revised through periodic rebidding.

**51. What, if any, safeguards should be adopted to ensure that large companies do not bid excessively low to drive out competition?**

If an exchange truly exhibits high costs, after taking into account an affordability benchmark and revenues from all relevant sources, it is unlikely that large companies will have so strong an incentive to drive away potential competitors that they will bid "excessively low." In any event, the objective of a bidding process is to *minimize* the level of universal service support necessary to cause service to be provided in the exchange, at affordable rates. If the incumbent is willing to serve a high-cost exchange with little or no universal service support, it is not appropriate to force the subsidy level up for the purpose of attracting other providers who are not willing to enter the market without a higher level of subsidy.

**52. What safeguards should be adopted to ensure adequate quality of service under a system of competitive bidding?**

As a condition of being certified as the winning bidder, and thus obtaining the right to receive a significant universal service support premium, the LEC should be required to agree to meet the prevailing quality of service standards set by the state public utility commission. Otherwise, the low bidder might simply be a carrier that intends to provide an inferior level of service quality; by setting the support level to meet that carrier's requirements, other carriers (who ought to receive less support than the low bidder) might, thus, also receive support insufficient to fund service of a satisfactory quality. The carrier should also be subject to decertification of its "low-bid" status (and thus lose its incremental support advantage) if it fails to maintain service quality consistent with the state public utility commission's service quality rules.

**53. How is collusion avoided when using a competitive bid?**

The Commission must be willing to impose stringent penalties for collusion in the bidding process. Possible sanctions could be disqualification from receiving support for serving areas bid in collusion with another carrier or disqualification from participating in the bidding process for some specified period of time. The Commission now has significant experience with auctions (from its licensing/spectrum allocation activities) and should rely on this experience to formulate rules for a fair and efficient bidding process for universal service support.

**54. Should the structure of the auction differ if there are few bidders? If so, how?**

If exchanges are genuinely high-cost in nature, it is likely to be more common than not to have only a few bidders participating in the auction. Thus, the "basic" auction structure could assume a bidding process with few bidders, rather than a large number of participants. If there are checks on collusion and a proxy-based ceiling for support, a unique structure for low-participation auctions should not be necessary.

**55. How should the Commission determine the size of the areas within which eligible carriers bid for universal service support? What is the optimal basis for determining the size of those areas, in order to avoid unfair advantage for either the incumbent local exchange carriers or competitive carriers?**

In order to conduct cost proxy analyses, a geographic area must be determined for which the relevant cost factor(s), e.g., population density, can be readily examined. The *bidding* area should correspond with an *economic service area* ("ESA"), i.e., an area reasonably related to an efficient serving plan and network architecture. In general, an ESA embraces a region no smaller than that which can be efficiently served from a single wire center or central office switching entity, including remote service units associated with the primary switch.

The boundaries of the bidding area or ESA should generally coincide with the boundaries of an existing wire center district (which may embrace less than a single exchange but usually does not embrace an area larger than a single exchange) served by the incumbent LEC.<sup>23</sup> The rationale for defining the LEC wire center as the ESA is that the initiative for high-cost funding comes from the LEC, and not from a prospective competitor. As such, it is reasonable that the installed infrastructure and architecture should serve as the foundation of the application of cost proxies and the basis for competitive bids.

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<sup>23</sup> Note that in some instances, particularly in urban areas, there are multiple wire center districts – and sometimes multiple exchanges – within a single municipality and that in other instances, particularly in more rural areas, a single wire center district may encompass more than one municipality.

Smaller geographic areas, such as Census Block Groups ("CBGs"), are not ESAs because they would not be served by a switching entity and distribution architecture confined to that particular geographic unit. Individual wire centers and central office switch entities can most efficiently serve thousands, or even tens of thousands, of households and businesses; CBGs embrace only a few hundred, and would never be adopted as the foundation of an efficient network architecture. Were the CBG (or another unit of comparable size) utilized as the bidding unit, only the incumbent would be in a position to serve the subject area efficiently, because the incumbent would be best equipped to supply the service from a larger, more expansive network. As such, an incumbent confronted with competing bids confined to a single CBG would in almost all cases be able to bid a lower support level than any other potential provider.

## SLC/CCLC

69. If a portion of the CCL charge represents a subsidy to support universal service, what is the total amount of the subsidy? Please provide supporting evidence to substantiate such estimates. Supporting evidence should indicate the cost methodology used to estimate the magnitude of the subsidy (e.g., long-run incremental, short-run incremental, fully-distributed).

Whether the carrier common line charge ("CCLC") continues to be necessary to support universal service depends in substantial measure on what the subsidy burdens for universal service will be in the future, as determined by forward-looking cost proxy models. Whether the CCLC actually is a subsidy needs to be examined closely by the Commission. Evaluation of whether the CCLC is a subsidy should rest upon a cost comparison based on proxy models to determine the difference between the price and the cost, rather than relying upon the LEC embedded costs used to calculate the CCLC.

TW Comm recommends that the Commission refocus its consideration of the extent to which the CCLC subsidizes universal service. The Commission must not only consider all sources of revenue, but consider the sources of the costs. In fact, with residential penetration rates now reaching into the mid-to-high-90% range, it appears that there is room to reduce subsidies to maintain the existing level of services, and that the 1996 Act's promise of greater efficiencies through competition will provide further opportunities for subsidy reduction.

Currently, the bulk of the support from interstate services for universal service is derived from the CCLC.<sup>24</sup> However, at this juncture in the universal service proceeding, the CCLC should not be singled out as a funding mechanism as this question appears to propose. Additional funding for universal service support is collected from other interstate and intrastate services provided directly by LECs and through direct assessments to interexchange carriers.

Focusing on the CCLC alone excludes numerous other possible sources of subsidy, including the following: yellow pages advertising revenues, local and intraLATA toll usage services priced in excess of cost, and vertical service features priced in excess of cost. Put simply, the Commission should not be singling the CCLC out from other subsidies that can provide support for universal service in the competitively neutral manner that the 1996 Act requires.

Rather than focusing on the CCLC alone, the necessary analysis must consider the other sources of subsidy, including but not limited to those enumerated above, to determine whether each of the subsidies, including the CCLC, is necessary and appropriate. Having considered these issues, TW Comm recommends that the CCLC should be eliminated for the following two reasons:

- (1) it is probably no longer necessary to support universal service as that term will be defined under Section 254; and
- (2) it is not competitively neutral.

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<sup>24</sup> The CCLC is calculated using LEC embedded costs separated according to Part 36 and configured in the manner prescribed by Part 69.

In the event that elimination of the CCLC leaves some subsidy "deficit" as determined by a cost proxy analysis, alternatives exist to cover it, including, if necessary, some minimal increase in the interstate Subscriber Line Charge ("SLC"). In fact, tracking studies conducted by the FCC and others since the onset of the SLC confirm that network drop-off due to the increased monthly price of residential access did not materialize as many opponents of the SLC had predicted when its implementation was being debated.<sup>25</sup> Thus, there is room for further Commission adjustment of the balance between the SLC and the CCLC should increases in the SLC become necessary.

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<sup>25</sup> In November 1994, 93.8 percent of U.S. households had telephone service. In November 1983, only 91.4 percent of U.S. households had telephone service. Monitoring Report, CC Docket No. 80-286 at Table 1.1 (May 1995).

70. If a portion of the CCL charge represents a contribution to the recovery of loop costs, please identify and discuss alternatives to the CCL charge for recovery of those costs from all interstate telecommunications service providers (e.g., bulk billing, flat rate/per-line charge).

Alternative billing schemes must be implemented through neutral mechanisms that do not favor incumbent local exchange carriers. The billing schemes must apply to all carriers in a nondiscriminatory manner as required by the 1996 Act. Under the present high-cost process, the FCC relies upon LECs' reported costs to determine whether assistance is warranted.<sup>26</sup> Reliance on LEC reported costs provides absolutely no incentives for LECs to control or to reduce costs, nor does it provide objective information on the costs associated with serving an area. The goal of the current proceeding is to improve the mechanisms by which universal service is assured. The system will not be improved by basing high-cost assistance on the aggregation of LEC-reported costs that are self-serving in the extreme. Basing high-cost assistance on the aggregation of reported costs will perpetuate the inefficiencies of current universal service mechanisms.

The inefficiencies and unnecessary expenditures that currently exist due to the current system's reliance on LECs' reported costs deny carriers of equity, objectivity, and fair competition. In contrast, a cost proxy approach, if properly structured, would result in a universal service fund that is

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<sup>26</sup> The interstate Universal Service Fund, adopted by the FCC in 1984, provides assistance to LECs serving customers in areas where the cost of local exchange loops exceeds 115% of the nationwide average loop cost for all LECs.

fair, compatible with the Commission's pro-competition goals, and economically efficient. Thus, it is preferable to distribute universal service subsidies based on objective factors directly related to the cost of providing service rather than by relying on LECs' reported costs. Adopting a carefully considered cost proxy approach would be a more equitable method of determining assistance, would further the Commission's goal of competitive neutrality, and would encourage high-cost support recipients to control their costs.

### Low-Income Consumers

71. Should the new universal service fund provide support for the Lifeline and Linkup programs, in order to make those subsidies technologically and competitively neutral? If so, should the amount of the lifeline subsidy still be tied, as it is now, to the amount of the subscriber line charge?

Services supported by federal universal service funds for rural, insular, and high cost areas should also be provided to low-income consumers.<sup>27</sup> Income-targeted support mechanisms, such as the Lifeline and Linkup programs, are well established and should be continued. The targeted support mechanisms currently funding state and federal lifeline programs, thus far, have been successful in ensuring that quality services are available to low-income consumers at just, reasonable, and affordable rates.

However, support for the federal Lifeline and Link-up programs should be provided for in a fund separate from the high-cost fund. Once separate funds are established, the cost proxy for the income-based subsidy should be the difference between the retail rate and the lifeline rate.

Lifeline and Linkup assistance programs target subsidies for low-income households by providing reduced installation and recurring rates for network connectivity. These targeted support programs are efficient because they focus on the specific needs of the community or class of consumer directly. Targeted subsidies are more effective than general support mechanisms in achieving universal service goals because they achieve the same degree of connectivity and ubiquity, but at a

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<sup>27</sup> NPRM, para. 50

small fraction of the costs. However, even targeted subsidies can have the undesirable effect of rewarding inefficiencies on the part of the incumbent provider. Thus, where targeted subsidies are warranted, as they are with low-income consumers, the responsibility of contributing to the fund must be accomplished in a competitively neutral manner.

Qualifying customers should be permitted to take service from any certified local carrier; hence, all low-income support mechanisms should be made "portable" and available to whichever carrier actually provides the service. Any customer that is eligible to receive a Lifeline or Linkup subsidy should be permitted to apply that subsidy to any qualifying local "dial tone" service that is available at the customer's location. This would imply a requirement that such subsidies be made explicit and that they be stated in terms of specific dollar amounts rather than as percentage "discounts" off the regular price of the service. The use of such explicit dollar lifeline subsidies has been adopted in some jurisdictions. For example, in Massachusetts, qualifying customers receive a fixed \$6 discount off their monthly residential rate, irrespective of which class of exchange service (i.e., measured, local flat, metropolitan flat) they select.<sup>28</sup>

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<sup>28</sup> The \$6 discount includes \$3.50 for the Subscriber Line Charge and \$2.50 of residential exchange reduction. DPU-Mass-No. 10, Exchange and Network Services, Part A, Section 1, 4th. revised page 11.1, effective June 11, 1995.

### Administration of Universal Service Support

72. Section 254(d) of the 1996 Act provides that the Commission may exempt carriers from contributing to the support of universal service if their contribution would be "de minimis." The conference report indicates that "[t]he conferees intend that this authority would only be used in cases where the administrative cost of collecting contributions from a carrier or carriers would exceed the contribution that carrier would otherwise have to make under the formula for contributions selected by the Commission." What levels of administrative costs should be expected per carrier under the various methods that have been proposed for funding (e.g., gross revenues, revenues net of payments to other carriers, retail revenues, etc.)?

TW Comm supports an exemption for carriers from the obligation to contribute to universal service in instances when the administrative costs of collecting the contribution exceed the carrier's contribution. Any determination of the levels that would trigger such an exemption, however, should not be made prior to the determination of manner of fund administration and the appointment of the Administrator of the fund. Once an Administrator is appointed, the Administrator's responsibilities should include the collection of contributions, disbursement of the fund, and review and adjustment of funding. The Administrator's duties relating to the collection and disbursement of the fund charge the Administrator with the responsibility of determining the level at which the administrative costs are too high to justify exempting that carrier from contribution obligations.

As the Commission accurately recognized in the NPRM, the Administrator must be a "candidate who can administer [the fund] in the most efficient, fair and competitively neutral

manner."<sup>29</sup> By appointing a neutral third party Administrator with the capacity to administer the fund in an even-handed and fair manner, the Commission need not decide the level of administrative costs now. Instead, any such decision should be deferred because the Administrator will be in the best position to make the necessary cost determinations.

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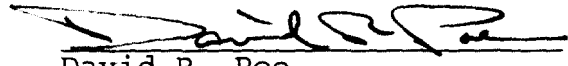
<sup>29</sup> NPRM, para. 118.

### Conclusion

In responding to the questions posed by the July 3, 1996 Public Notice, TW Comm seeks to promote rational and consistent policies which will ensure adequate, reliable, and efficient service for consumers nationwide. As the 1996 Act requires, high cost assistance calculation and distribution must be accomplished in a competitively neutral manner. To do so, the calculation and distribution of universal service support must rely on forward-looking, cost proxy models that reflect the true economic cost of providing service. By adopting the recommendations made in TW Comm's responses to the July 3, 1996 Public Notice, the Commission will substantially further its goals.

Respectfully submitted,

**TIME WARNER COMMUNICATIONS  
HOLDINGS, INC.**



David R. Poe  
Catherine P. McCarthy

Its Attorneys

LeBoeuf, Lamb, Greene &  
MacRae LLP  
1875 Connecticut Avenue, N.W.  
Washington, DC 20009  
(202) 986-8000

Dated: August 2, 1996

CERTIFICATE OF SERVICE

I, Catherine P. McCarthy, hereby certify that on this 2nd day of August, 1996, a true copy of the foregoing Comments filed by Time Warner Communications Holdings, Inc., were sent via First Class Mail, Postage Prepaid, or Hand Delivered, upon each of the parties on the attached Service List.

Catherine P. McCarthy  
Catherine P. McCarthy

Service List

Office of the Secretary\*  
Federal Communications Commission  
1919 M Street, N.W.  
Washington, DC 20554

International Transcription Service\*  
1990 M Street, N.W.  
Room 640  
Washington, DC 20036

Ernestine Creech, Common Carrier Bureau\*\*  
Federal Communications Commission  
2000 L Street, N.W., Suite 257  
Washington, DC 20584

The Honorable Reed E. Hundt  
Chairman  
Federal Communications Commission  
1919 M Street, N.W. -- Room 814  
Washington, DC 20554

The Honorable Andrew C. Barrett  
Commissioner  
Federal Communications Commission  
1919 M Street, N.W. -- Room 826  
Washington, DC 20554

The Honorable Susan Ness  
Commissioner  
Federal Communications Commission  
1919 M Street, N.W. -- Room 832  
Washington, DC 20554

The Honorable Julia Johnson  
Commissioner  
Florida Public Service Commission  
Capital Circle Office Center  
2540 Shumard Oak Blvd.  
Tallahassee, FL 32399-0850

The Honorable Kenneth McClure  
Vice Chairman  
Missouri Public Service Commission  
301 W. High Street, Suite 530  
Jefferson City, MO 65102

The Honorable Sharon L. Nelson  
Chairman  
Washington Utilities and Transportation Commission  
P.O. Box 47250  
Olympia, WA 98504-7250

The Honorable Laska Schoenfelder  
Commissioner  
South Dakota Public Utilities Commission  
500 E. Capital Avenue  
Pierre, SD 57501

Martha S. Hogerty  
Public Counsel for the State of Missouri  
P.O. Box 7800  
Harry S. Truman Building, Room 250  
Jefferson City, MO 65102

Deborah Dupont  
Federal Staff Chair  
Federal Communications Commission  
2000 L Street, N.W., Suite 257  
Washington, DC 20036

Paul E. Pederson  
State Staff Chair  
Missouri Public Service Commission  
P.O. Box 360  
Truman State Office Building  
Jefferson City, MO 65102

Eileen Benner  
Idaho Public Utilities Commission  
P.O. Box 83720  
Boise, ID 83720-0074

Charles Bolle  
South Dakota Public Utilities Commission  
State Capital, 500 E. Capital Avenue  
Pierre, SD 57501-5070

William Howden  
Federal Communications Commission  
2000 L Street, N.W. Suite 812  
Washington, DC 20036

Lorraine Kenyon  
Alaska Public Utilities Commission  
1016 West Sixth Avenue, Suite 400  
Anchorage, AK 99501

Debra M. Kriete  
Pennsylvania Public Utilities Commission  
P.O. Box 3265  
Harrisburg, PA 17104-3265

Clara Kuehn  
Federal Communications Commission  
2000 L Street, N.W., Suite 257  
Washington, DC 20036

Mark Long  
Florida Public Service Commission  
2540 Shumard Oak Blvd.  
Gerald Gunter Building  
Tallahassee, FL 32309-0850

Samuel Loudenslager  
Arkansas Public Service Commission  
P.O. Box 400  
Little Rock, AR 72203-0400

Sandra Makeeff  
Iowa Utilities Board  
Lucas State Office Building  
Des Moines, IA 50319

Philip F. McClellane  
Pennsylvania Office of Consumer Advocate  
1425 Strawberry Square  
Harrisburg, Pennsylvania 17120

Michael A. McRae  
D.C. Office of the People's Counsel  
1133 15th Street, N.W. -- Suite 500  
Washington, D.C. 20005

Rafi Mohammed  
Federal Communications Commission  
2000 L Street, N.W. Suite 812  
Washington, DC 20036

Terry Monroe  
New York Public Service Commission  
Three Empire Plaza  
Albany, NY 12223

Andrew Multz  
Federal Communications Commission  
2000 L Street, N.W. Suite 257  
Washington, DC 20036

Mark Nadel  
Federal Communications Commission  
1919 M Street, N.W., Room 542  
Washington, DC 20555

Gary Oddi  
Federal Communications Commission  
2000 L Street, N.W., Suite 257  
Washington, DC 20036

Teresa Pitts  
Washington Utilities and Transportation Commission  
P.O. Box 47250  
Olympia, WA 98504-7250

Jeanine Poltronieri  
Federal Communications Commission  
2000 L Street, N.W., Suite 257  
Washington, DC 20036

James Bradford Ramsay  
National Association of Regulatory Utility Commissioners  
1201 Constitution Avenue, N.W.  
Washington, DC 20423

Jonathan Reel  
Federal Communications Commission  
2000 L Street, N.W., Suite 257  
Washington, DC 20036

Brian Roberts  
California Public Utilities Commission  
505 Van Ness Avenue  
San Francisco, CA 94102-3298

Gary Seigel  
Federal Communications Commission  
2000 L Street, N.W., Suite 812  
Washington, DC 20036

Pamela Szymczak  
Federal Communications Commission  
2000 L Street, N.W., Suite 257  
Washington, DC 20036

Whiting Thayer  
Federal Communications Commission  
2000 L Street, N.W., Suite 812  
Washington, DC 20036

Deborah S. Waldbaum  
Colorado Office of Consumer Counsel  
1580 Logan Street, Suite 610  
Denver, Colorado 80203

Alex Belinfante  
Federal Communications Commission  
1919 M Street, N.W.  
Washington, DC 2055

Larry Povich  
Federal Communications Commission  
1919 M Street, N.W.  
Washington, DC 2055

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\*\* Diskette Filed